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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)
MAJOR RAIL CONSOLIDATION PROCEDURES
Notice of Proposed Rulemaking

COMMENTS OF
THE DOW CHEMICAL COMPANY

Jeffrey O. Moreno
Thompson, Hine & Flory LLP
1920 N Street, N.W., Suite 800
Washington, D.C. 20036
(202) 331-8800
Attorney for The Dow Chemical Company

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I. Introduction

The Dow Chemical Company ("Dow") respectfully submits these comments in response to the Notice of Proposed Rulemaking ("Notice") served by the Surface Transportation Board ("STB" or "Board") in the above-captioned proceeding on October 3, 2000. Dow welcomes this opportunity to submit its views on the Board's proposed revisions to its rail merger policy.

A. Identity and Interest of Dow.

Dow, headquartered in Midland, Michigan, is one of the world's largest manufacturers of chemicals, plastic materials, hydrocarbons, and numerous specialty products. Dow, including its subsidiaries and affiliates, operates numerous production facilities throughout North America. The largest of these facilities are located near Freeport, Texas; Plaquemine, Louisiana; Fort Saskatchewan, Alberta; and Midland, Michigan. The Freeport facility is among the largest in the world.

Dow relies extensively upon rail transportation to move products to, from, and between its North American facilities. Rail is a cost-effective mode for transporting large volumes of Dow's chemical and plastic commodities long distances over land. In addition, Dow relies heavily upon rail transportation for the safe movement of hazardous or dangerous chemicals.

B. Overview of Dow's Comments.

Dow commends the Board for recognizing and addressing the need to enhance competition in the rail industry. Dow agrees that the Board's rail merger policies must be substantially revised to meet the needs of rail carriers and shippers in light of today's highly-concentrated rail industry. The Board's new approach to rail mergers must be to "enhance" rather than to simply "preserve" competition.

The Board's current merger policy, which is over 20 years old, clearly favors rail mergers. The proposed policy makes two long overdue and significant changes. First, the rules shift the Board's merger evaluation process away from a decidedly pro-merger stance to a more objective position by establishing new procedural and substantive requirements for merging carriers that "raises the bar" for merger applicants. The second, and more significant, change is the requirement that merging carriers propose "enhanced competition" in order to cure the complex and subtle – but very real – losses in competition that have been permitted to go unremedied in previous mergers.

The proposed rules represent a clear departure from prior merger policies. For example, the Board directs carriers to preserve existing gateways and protects the right of shippers to enter into contracts for one segment of a movement as a means of gaining the right to pursue rate relief for the remainder of the movement. This step impliedly discards the "one-lump" theory. The Board also recognizes, for the first time, that mergers do result in the loss of geographic competition. Dow views all of these changes positively.

Dow, however, is concerned that the proposed rules lack sufficient specificity in major areas. The rules are too vague or general to provide clear notice and guidance to shippers and carriers of the standards that will be applied and what will be expected. Moreover, the rules are drafted so broadly that they could be applied in a way that accomplishes no real changes over the current rules. Although the Board needs some flexibility to address different situations, shippers and carriers need sufficient specificity to provide them with clear notice of the applicable standards and adequate guidance as to how those standards will be applied.

Dow also is concerned that the Board's insistence upon addressing competition only as it pertains to merging carriers will undermine the overall goal of enhanced competition. The concern is twofold. First, this limited focus will create an uneven playing field both among carriers and among shippers, since some will be subjected to enhanced competition while others will not. Second, it ignores the competitive harms of past mergers and their cumulative effects over time from one merger to the next. These effects may chill future mergers and leave many competitive harms unremedied.

Finally, the proposed rules fail to address several important issues at all. For example, they fail to address arbitration, which would make enhanced competition and regulatory protections available to many more shippers by simplifying and expediting the dispute resolution process. Nor do the rules afford shippers any protection from acquisition premiums if the merger benefits are overstated. These are important issues that are closely related to the STB's goals in this proceeding.

Each of Dow's concerns is addressed with more specificity in the comments below.

II. The Proposed Rules Must Be Clarified and Expanded in Order to Fully Realize the Goal of Enhanced Competition.

Dow supports the Board's goal to enhance competition as part of the rail merger rules. The proposed rules, however, are very general and, in some places, ambiguous. Moreover, they are restricted only to merging carriers. Although Dow recognizes the Board's need for flexibility in its merger policy to address situations as they arise, Dow is concerned that the proposed rules do not strike the proper balance between flexibility and specificity. In addition, Dow is concerned that the Board's reluctance to extend the focus of this proceeding beyond just merging carriers ignores a critical piece of the equation for providing enhanced competition.

A. The Proposed Rules Should Clearly Emphasize Enhanced Intramodal Competition.

The scope of the Board's goal to enhance competition is not clear in the current formulation of the rules. For example, Proposed § 1180.1(b) provides that "the Board must consider the various goals of effective competition . . ." among other factors in determining the public interest. In addition, § 1180.1(c) requires merger applications to "include provisions for enhanced competition." This language does not clearly refer to effective or enhanced rail, or intramodal, competition, which leaves it open to an interpretation that intermodal, geographic, or product competition could substitute for rail competition and still satisfy the Board's goal. Such an interpretation would be no different from the standards that the Board currently applies. Therefore, Dow asks the Board to clarify that its goal is to ensure enhanced and effective intramodal competition.

B. The Board Should Clarify that a "Financially Sound" Carrier Need Not Be a Revenue Adequate Carrier.

Section 1180.1(c) contains a significant exception that could swallow the proposed goal to enhance competition. As proposed, this section reads:

> Unless merger applications are so framed [to include provisions for enhanced competition], approval of proposed combinations <u>where both carriers are financially sound</u> will likely cause the Board to make broad use of the powers available to it in 49 U.S.C. 11324(c) to condition its approval to preserve and enhance competition.

[emphasis added] Dow is concerned by the Board's undefined reference to "financially sound" carriers.

If the Board were to equate "financially sound" with "revenue adequate," a most perverse result would ensue. Very few Class I rail carriers are deemed to be revenue adequate under the Board's current measures. Thus, if "financially sound" is equated with "revenue adequate," the requirement that future merger applications include provisions for enhanced competition will not apply to any of the four major carriers most likely to be involved in future rail combinations. This would render the Board's proposed new goals and objectives to enhance competition nothing more than window dressing.

Moreover, the most recent rail mergers have contributed significantly to the revenue-inadequacy of several Class I carriers. Most notably, the acquisition premium paid by CSX and Norfolk Southern for Conrail has weakened both carriers' levels of revenue-adequacy, as measured by the Board.[1] The post-merger service problems of CSX and NS also have had adverse financial consequences for both carriers. Thus, to use revenue-adequacy as a measure of "financially sound" would allow the missteps of past mergers to preclude enhanced competition conditions in future mergers.

The Board must cure the uncertainty surrounding the definition of "financially sound" by specifically disavowing revenue adequacy as a factor in that determination. Any other result would seriously dilute, if not negate, the goal of the proposed rules to enhance competition.

C. Competition Cannot Truly Be Enhanced Unless It Extends to the Entire Rail Industry

Dow is disappointed that the Board has ignored calls by Dow, and others, to extend the objective of enhanced competition beyond just merging carriers to the entire rail industry. Dow is concerned that, by focusing purely on the rail merger policy to

[1] Dow is aware of the pending appeal of the STB's Conrail decision with respect to the issue of the acquisition premium. However, regardless whether the price paid for Conrail is a premium or "fair value," the STB cannot deny the mathematical fact that the price has adversely affected the revenue-adequacy of both carriers.

enhance competition, the Board is creating an unlevel playing field that will undermine the overall goal even as applied to just merging carriers.

The Board recognizes that its proposed merger rules "represent a paradigm shift in our review of major mergers." Notice at 10. The premise for this shift is that mergers have reduced most rail excess capacity and improved operational efficiency. Moreover, the Board observes that the last few mergers have resulted in significant service problems. As a result, the Board now believes it is appropriate to increase the significance of enhanced competition as a public interest factor in future mergers.

Dow submits, however, that these premises for the proposed shift in merger policy were largely present even prior to the previous round of rail mergers. Those mergers resulted in substantial reductions in competition and left the nation with rail duopolies in the Eastern and Western portions of the United States. As such, enhanced competition was a fully justified goal even in earlier mergers and the lost competition resulting from those mergers also must be remedied.

Furthermore, very few captive rail shippers have true competition today. Even facilities currently served by two rail carriers are not truly competitive for most movements. In order for a rail shipper to enjoy the benefits of two-carrier competition at a facility, the same two carriers either must serve both the origin and destination points or serve only one of those points so that the bottleneck origin or destination carrier is neutral.[2] The former scenario is largely non-existent today and the latter has decreased dramatically with each prior rail merger. These harms must be remedied before competition truly can be enhanced.

Dow also is concerned that the Board's focus only upon merging carriers may actually chill future mergers, even positive ones, and thereby prevent shippers from realizing enhanced competition at all. In order to enhance competition, merging carriers

[2] Although Dow believes that it enjoys the benefits of competition in the latter scenario, the Board's "one-lump" theory disclaims the existence of such competition.

would be required to provide some type of access to their rail systems. Dow is concerned that carriers will be reluctant to merge if they are required to make their customers more competitively accessible to other rail carriers while they do not have similar access to their competitors' customers. This will result in a significant disincentive for carriers to merge and will create an inequitable situation for shippers on the non-merging carriers.

For these reasons, Dow believes that the Board, at a minimum, should revise its rules for obtaining reciprocal switching. Specifically, the Board should reevaluate its restrictive competitive access rules, under which no shipper has ever succeeded, to provide for increased reciprocal switching access immediately. The Board should eliminate the "competitive abuse" test and establish clear and definite pro-competitive standards for obtaining reciprocal switching under 49 U.S.C. § 11102. Only through this expanded scope will the full benefits of enhanced competition be realized.

D. When Addressing Specific Competitive Harms, the Board Should Err on the Side of Increased Competition.

The proposed merger rules do not alter the current standards for addressing specific competitive harms. Dow has identified at least one area where the STB can and should be more explicit as to both the level and type of enhanced competition that it will require of merging carriers when a specific harm has been identified. In prior merger decisions, the Board has refused to grant a full remedy for certain specific harms because the only remedy that would fully restore pre-merger competition levels also would leave the shipper in a better competitive position than it was pre-merger. That policy, which worked to the carriers' advantage at the expense of the shipper, is not consistent with the Board's new emphasis on enhanced competition.

Dow asks the Board to formally reverse this policy in the proposed merger rules. In future rail mergers, the Board should err on the side of enhancing competition in order to address specific competitive harms that otherwise could not be fully remedied. Such a rule would be consistent with the proposed requirement that merger applications include provisions for enhanced competition. That requirement addresses general competitive harms that are difficult to specify, while Dow's proposed requirement would address competitive harms that can be specifically identified.

III. The STB Must Do More to Protect Shippers from Merger-Related Service Disruptions.

Dow applauds the STB's goal to protect shippers from merger-related service disruptions. The proposed Service Assurance Plan ("SAP") is an excellent method, if properly implemented, to minimize the risk of service disruptions. In addition, the proposed Service Council, which has been beneficial throughout the Conrail acquisition, is a helpful means of preserving open lines of communications between shippers and the merging carriers. The proposed rules, however, are deficient as they pertain to remedies in the event service disruptions still occur.

The proposed rule at § 1180.1(c)(2)(iii) only requires merger applicants to "explain how they will cooperate with other carriers in overcoming natural disasters or other serious service problems . . . ." No minimum remedies are proposed.

Dow submits that the Board can and should impose certain minimum service remedies. Specifically, the Board should require the applicants' service contingency plan to include the right of a shipper to short-haul a carrier, during service disruptions, by requiring a carrier, at the shipper's request, to interchange traffic at the nearest interchange point. This would minimize a shipper's exposure to service disruptions while diverting traffic off of an overburdened rail system at the earliest possible point. Moreover, this remedy would not burden the troubled rail system with the trackage rights operations of a second carrier. Despite the operational benefits to the affected carrier, it has been Dow's experience in past service crises that carriers are loathe to give up this captive traffic even for short durations. Therefore, Dow strongly believes that a rule is essential to ensure that this mutually beneficial action is taken.

Although the Board currently has emergency service rules, those rules do not provide for the remedy proposed by Dow. Moreover, those rules can take up to 30 days to obtain relief and, even in their expedited form, require evidence and facts that can be difficult to gather and present in a short time frame and undoubtedly would be contested by the carriers. The limits of the existing rules are illustrated by the small number of shippers who have sought relief under those rules during the current rail service crisis in the East.

IV. The Board Should Clearly and Unequivocally Abandon the "One-Lump" Theory.

The Board has taken a very positive step towards preserving competition by requiring merging carriers to present an effective plan to keep open major existing gateways and to preserve separately challengeable segment rates to be used in conjunction with contract rates in bottleneck situations. The latter scenario, known as the "contract exception," is a tacit acknowledgment that the Board no longer will adhere strictly to the so-called "one-lump" theory. Dow strongly urges the Board to go further and expressly abandon the theory altogether.

A. The "One-Lump" Theory is Inconsistent with the "Contract Exception."

The "one-lump" theory holds that, because a monopolist at the end stage of production is in a position to capture the entire monopoly profit, integration backwards upstream normally does not enable it to raise the profit-maximizing price. Thus, for movements from A to C, where only one carrier serves from A to B, but two carriers serve from B to C, the Board has held that a merger of the sole AB carrier with one of the BC carriers does not result in a loss of competition because the AB, or "bottleneck," carrier already reaps the monopoly profit for the entire AC movement even prior to the merger.

If the "one-lump" theory truly reflected reality, preservation of the "contract exception" would not be a pro-competitive measure. This is because the "contract exception" applies in exactly the same circumstances in which the "one-lump" theory has been applied. Yet, the Board clearly has recognized it as pro-competitive in the Notice, at pp. 15-16 and Proposed § 1180.1(c)(2)(i), and in the "Bottleneck Decisions."[3] Moreover, the competitive benefits of the "contract exception" were recognized in a recent court decision affirming the exception.

> By permitting a shipper to enter into contracts that are beyond review of the Board, the Staggers Act entitles a contracting shipper to . . . "the benefit of its bargain." Were its position to prevail, Union Pacific [the bottleneck carrier] would be in a position to recover for itself the "benefit of FMC's bargain with CSX [the non-bottleneck contract carrier], as it could set a rate that allowed it to obtain the difference between a reasonable through rate and the FMC-CSX contract price.

Union Pacific R.R. Co. v. STB, 202 F.3d 337, 342 (D.C. Cir. 2000).

The "one-lump" theory and the "contract exception" are inconsistent. If there is a competitive benefit to be preserved in the "contract exception," there is no basis for continued adherence to the "one-lump" theory. Dow urges the Board to expressly acknowledge this inconsistency by explicitly abandoning the presumptions behind the "one-lump" theory altogether.

B. The Board Should Remedy the Harms Resulting from Past Adherence to the "One-Lump" Theory.

Unfortunately, the Board's unquestioned adherence to the "one-lump" theory for nearly twenty years has eliminated significant levels of competition with each successive rail merger. Although there is little the Board can do to correct those past competitive

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[3] *Central Power & Light Co. v. Union Pacific R.R. Co.*, Nos. 41242 et al., 1996 STB LEXIS 358 (served Dec. 31, 1996), *clarified* 1997 STB LEXIS 91 (served May 1, 1997), *aff'd in part, MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8^{th} Cir. 1999).

harms, it can attempt to ameliorate those harms through relevant pro-competitive conditions upon future mergers.

Dow asks the Board to require all merging rail carriers to offer common carrier "bottleneck" rates to shippers regardless whether the bottleneck carrier serves both the origin and destination points. A shipper, however, would not be able to demand any interchange point that it desires. Rather, a shipper would be permitted to obtain a bottleneck rate only to a point where traffic was interchanged prior to the proposed merger and such interchange would remain feasible after the merger was completed.

Such a condition also would preserve competition based upon service. The "one-lump" theory focuses only upon rates, while ignoring service-based competition. Thus, even if the "one-lump" theory were not inconsistent with the "contract exception," a vertical merger of a bottleneck carrier with a downstream non-bottleneck carrier still would deny captive shippers a choice of rail carriers for the competitive segments of their routes. This competition is an incentive for carriers to provide good rail service, including safer transportation of hazardous substances, which is of paramount importance to Dow.

V. The STB Should Require Merging Carriers to Arbitrate Service and Rate Disputes.

A major deficiency in the Board's proposed rules is the absence of any process for the efficient and expeditious resolution of service and rate disputes. Many of the pro-competitive measures in the rules will be severely limited in their effect unless the Board simplifies and expedites the process for resolving such disputes. To remedy this deficiency, Dow urges the Board to require mandatory binding arbitration, at the shipper's discretion.

Although arbitration has become much more common in other industries as a method for quickly resolving commercial disputes, it is not prevalent for rail transportation, primarily because carriers rarely will agree to it. Dow can only guess at the reasons for this. Whether or not it is because carriers believe that they are better served by the lengthy proceedings at the Board or before courts, clearly there is a lack of incentive for them to arbitrate.

From a shipper's perspective, however, arbitration would make statutory and regulatory protections more widely available. Arbitration is more affordable and less time-consuming. Both of these factors are major obstacles that shippers must overcome today in order to obtain relief in service and rate disputes.

A. Arbitration of Service Disputes Will Provide Shippers with True Remedies.

The UP/SP service "meltdown" in 1997 and the service interruptions resulting from the NS/CSX division of Conrail left many shippers, including Dow, frustrated with the process for obtaining remedies and restitution. They were forced to resort to lengthy and expensive court proceedings to obtain redress. Only shippers with the largest losses could justify this expenditure of time, effort and resources. Many shippers who sustained substantial and devastating losses nevertheless were unable to assume the risk and expense associated with litigation of their claims. Those shippers were effectively denied a remedy.

Because the carriers know that most shippers will not, or cannot, pursue litigation, they often refuse to offer a reasonable settlement. Only when there is a credible threat of litigation will the carriers engage in serious negotiations. It is unfortunate that a shipper often must initiate legal action even to have the opportunity to recover its damages from the otherwise clear and acknowledged responsible party. If arbitration were available as a less costly and more expeditious alternative, more shippers would be able to seek relief.

The Board can address this issue by imposing a merger condition that would require applicants to arbitrate service-related loss and damage claims, if the shipper so elects. The shipper would retain the right to submit its claims to a court if it desired to do so.

Although the Board does not have jurisdiction to adjudicate loss and damage claims or contract disputes, it still has the legal authority to impose an arbitration condition upon a merger. In the Conrail acquisition decision, *CSX Corp. et al.--Control and Operating Leases/Agreements--Conrail Inc. et al.*, STB Finance Docket No. 33388, Decision No. 89, p. 74 (served July 23, 1998), the Board invoked its authority under 49 U.S.C. §11321 to void contract anti-assignment clauses. Also, in *Rules, Regulations, and Practices of Regulated Carriers with Respect to the Processing of Loss and Damage Claims*, 340 I.C.C. 515, 540 (1972), the former ICC concluded that it had sufficient authority "to establish proper and reasonable procedures for the timely, proper, and efficient processing and disposition of loss, damage, and other similar claims."

Under Dow's proposal, the Board could require the applicants to agree to binding arbitration as a condition of the merger, under 49 U.S.C. § 11321, for both common and contract carriage claims. The Board would not violate the contract rights of any shipper if the decision to arbitrate remains within the shipper's discretion. Under the same principal used to promulgate claims processing regulations, the Board also may adopt a procedural framework for the conduct of these arbitrations. The Board, however, should not place itself in a position to review the arbitration decisions, since that could violate the jurisdictional allocations in the Carmack Amendment.

B. Without Simplified Rate Review Procedures, Most Shippers Will Not Benefit from the "Contract Exception."

The vast majority of shippers, including Dow, will not benefit from bottleneck relief, including the "contract exception," unless the Board simplifies the process for resolving rate disputes. Otherwise, most shippers will not be willing or able to pursue the complex and costly process of challenging a bottleneck rate before the Board. Therefore, Dow strongly urges the Board, as a condition upon future rail mergers, to require the applicants to establish bottleneck rates and to arbitrate, upon demand by the shipper, any disputes over the level of those rates.

The current process for resolving rate disputes requires a shipper to bring an unreasonable rate complaint before the Board under procedures that are extremely complex, require enormous amounts of discovery, take a year or more to complete (not including appeals), and cost hundreds of thousands of dollars to pursue. Is it any wonder that shippers file so few rate cases? Moreover, those cases that are filed typically involve single commodity (*e.g.*, coal) unit-train movements over a single route on a regular basis. Most rail movements, however, do not have these characteristics.

Dow, for example, is a very large volume shipper. It tenders 95,000 rail cars per year from its major North American production facilities. This amounts to over 26,000 rail cars per year out of its Freeport, Texas facility; 22,000 rail cars per year out of its Plaquemine, Louisiana facility; and 25,000 rail cars per year out of its Ft. Saskatchewan, Alberta facility. All of these facilities are captive to a single rail carrier. Dow's traffic, however, is spread over more than 3000 origin-destination pairs and its traffic patterns change frequently. Most of these origin-destination pairs may only handle an average of 20-30 cars per year. If Dow believes that its rail rates are unreasonable, it currently must bring as many as 3000 different rate complaints. By the time the Board issues a decision, traffic no longer will move over many of these lanes. The potential savings over any individual traffic lane do not justify the cost and effort to file a rate complaint. Nevertheless, the cumulative impact of paying an unreasonable rate over all of these traffic lanes is enormous.

As a practical consequence of these facts, Dow does not now, and would not under the proposed merger rules, benefit from the "contract exception" or other forms of bottleneck rate relief. Dow's experience is representative of most shippers and their traffic, except that most other shippers have even smaller volumes of traffic than Dow. Thus, the rate review process is the "bottleneck" standing between most shippers and the benefits of enhanced competition, not to mention basic regulatory protections.

Dow urges the Board to adopt the Canadian system of Final Offer Arbitration ("FOA"). Canadian Transportation Act §§ 161-169. Under that system, a shipper who is dissatisfied with a rate charged or proposed to be charged by a rail carrier may submit the matter for FOA by a single arbitrator or, if the carrier agrees, by a panel of three arbitrators. Each party sets forth its final offer to the other and the arbitrator must choose one or the other. The parties must exchange all information that they intend to submit to the arbitrator and they may direct interrogatories to each other. The arbitrator also may request additional information on her own initiative. Depending upon the dollar amount of the freight charges at issue, the arbitration must be completed within either 30 or 60 days. The decision of the arbitrator is final and binding.

The FOA procedures are simple, cost-effective, and expeditious. Moreover, because the arbitrator must decide only between the offers of the shipper and the carrier, both parties have a strong incentive to be reasonable in their approach.

Dow believes that the Board has the authority to impose FOA upon merging carriers under its broad merger conditioning authority at 49 U.S.C. §§ 11321(a) and 11324(c). These provisions, respectively, exempt merging carriers from all laws necessary to let them carry out the transaction and permit the Board to impose conditions to alleviate anti-competitive effects or other harm to the public interest. FOA would broaden the range of shippers who will benefit from any bottleneck relief and the "contract exception" in particular, which clearly would be within the public interest.

C. Mandatory, Binding Arbitration Will Make the Board's Pro-Competitive Proposals More Widely Available to Shippers.

Similar to the discussion of bottleneck rate determinations in the preceding section, many of the enhanced measures proposed by the Board will not benefit shippers due to the costly and time-consuming process of pursuing them. Dow urges the Board to consider mandatory, binding arbitration as a means to make both existing and proposed competitive benefits available to a broader range of shippers.

Dow already has commented on the need to increase competition among all rail carriers rather than just merging carriers. As part of those comments, Dow has urged the Board to revisit its standards for competitive access petitions. In order to fully and effectively implement any changes, Dow urges the Board to require arbitration of competitive access disputes.

Arbitration also could streamline the resolution of disputes over competitive conditions imposed upon a merger, as well as service-related disputes. For example, disputes over the application of a merger condition (except general disputes over the meaning of a merger condition, or other broad policy disputes, which would be resolved by the Board in the first instance) or disputes over rail service arising within a specified time after implementation of a merger would be submitted to binding arbitration. The Board could establish the standards and procedures for resolving the disputes and require that arbitration be completed within a fixed time period. This would resolve many of the obstacles that shippers face in their attempts to realize the full benefit of all pro-competitive options.

VI. The Board Must Do More Than Simply Increase Its Scrutiny of Public Interest Benefits.

In support of Proposed § 1180.1(c)(1), the Board has stated that it "would take particular care to scrutinize future claims of merger benefits and associated timeframes to ensure that they are well-documented and reasonable projections." Notice at 14. The goal is to "ensure that applicants are careful in the presentation of public benefits." *Id.* Dow supports both the process and the goal, but believes the Board must do even more to protect shippers from inflated, or unsubstantiated, claims of merger benefits.

Dow does not understand how the proposed process of scrutinizing merger benefits to ensure that they are "well-documented" and "reasonable" will differ from current procedures. It is unclear what standards the Board uses today or, for that matter, the new standards that the Board is proposing. This makes it difficult to understand how the proposed standards have changed. Does the Board mean to suggest that its current procedures do not require well-documented and reasonable projections? Certainly, some parties have characterized the Board's analysis this way in the past.

Regardless of the greater scrutiny proposed by the Board, Dow does not believe that merger benefits can be projected and assessed with any reasonable certainty. Too many variables and assumptions are required and the entire process is subject to substantial manipulation by the applicants to achieve any desired result. Not even increased scrutiny of claimed benefits by the Board will do much to enhance the reliability of benefit projections. This places a high level of responsibility upon the Board to protect the public interest from potentially adverse effects if the projected benefits are not fully realized.

The greatest single threat from overstated benefit projections is their use to justify an acquisition premium. If not offset by merger benefits, an acquisition premium can adversely affect the rates of shippers.

Captive shippers are most at risk because they rely upon regulation to ensure that their rates are reasonable. Whenever assets are sold, the acquisition cost becomes the new book value. An acquisition premium increases the book value. These higher book values are used to calculate the jurisdictional threshold for regulation and railroad revenue-adequacy. The changes to both of these calculations, as a result of an acquisition premium, will adversely affect regulated rates if the premium is not offset by merger benefits.

Many contract shippers also are at risk as a result of their rail contracts. For example, many rail contracts set a base rate that is adjusted periodically. A common adjustment factor is the Rail Cost Adjustment Factor ("RCAF"). An acquisition premium that is not offset by merger benefits can inflate the RCAF, through the depreciation component, and cause contract rates to rise at a faster pace.

The Board must protect shippers from the adverse effects of an overstated acquisition premium. Given the inexact art of estimating merger benefits, it is not sufficient for the Board to increase its scrutiny of projected benefits. Rather, the Board should require merger applicants to propose ratepayer protection mechanisms to assure that customers are protected if the projected benefits do not materialize. This solution, which already has been adopted by the Federal Energy Regulatory Commission,[4] places the risk that benefits will not materialize upon the applicants, where it belongs.

The Board already has taken a positive step in this direction in Proposed §1180.1(c)(1) with its expectation that applicants will "propose additional measures that the Board might take if the anticipated public benefits fail to materialize in a timely manner." This language is insufficient, however, because it does not protect shippers from the potentially adverse effects of an acquisition premium by imposing a protective condition from the outset of the merger. Rather, it only requires applicants to propose measures that *might* be taken *if* the anticipated benefits fail to materialize. The Board does not specify how or when it would measure the occurrence of the anticipated benefits. As written, the proposed rule does not provide any real protection to shippers and the hint of possible protection at a later date would come too late for many shippers.

Dow proposes that the following sentence be added at the end of Proposed 1180.1(c)(1) in order to address these deficiencies:

> The applicants also should propose ratepayer protection mechanisms that will assure that shippers are protected from the effects of the acquisition price upon their rates, if the projected merger benefits do not materialize

This language is intended to protect shippers while taking nothing away from the applicants if their merger benefits in fact do materialize.

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[4] *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, III FERC Stats. & Regs. (CCH) 31,044, 30,123 (1996).

VII. The Board Should Address the Level of Scrutiny that will be Given to Alliances and Joint Ventures.

The Board, in Proposed § 1180.1(c), has indicated its intention to consider whether the claimed benefits of a merger "could be realized by means other than the proposed consolidation . . . such as joint marketing agreements and interline partnerships." Notice at 13-14. Without knowing the specifics of a particular transaction, Dow reserves its opinion as to whether such non-merger cooperative agreements might be more preferable. Dow is concerned, however, that such agreements might escape Board scrutiny and preclude shippers from realizing the benefits enhanced competition, as proposed in the new merger rules.

Dow believes that most non-merger cooperative agreements should be subject to Board review. The statute purposefully defines both "control" and achievement of control very broadly. *See* 49 U.S.C. § 10102(3) and 11323(b) and (c); *see also U.S. v. Marshall Transport Co.*, 322 U.S. 31, 38 (1944). However, recent decisions of the Board and its predecessor, the Interstate Commerce Commission, seem to follow a narrower definition of control that could conclude that many cooperative agreements do not require regulatory approval.

For example, in Finance Docket No. 33556, *Canadian National Railway Company, Grand Trunk Corporation, And Grand Trunk Western Railroad Incorporated—Control—Illinois Central Corporation, Illinois Central Railroad Company, Chicago Central, And Pacific Railroad Company, And Cedar River Railroad Company* ("CN/IC"), the Board found that a so-called "alliance agreement" between the Canadian National Railway system and the Kansas City Southern Railway system was not subject to the Board's authority. The Board determined that, on the facts presented on the record, the alliance was not a form of common control requiring approval under 49 U.S.C. §§ 11323-24. The Board also concluded that the alliance agreement was not a pooling agreement that would require Board approval under 49 U.S.C. §11322. CN/IC at 26-28.[5]

Similarly, the ICC, in *Union Pacific R. Co. - Trackage Rights over Chicago and North Western Transp. Co.,* 7 I.C.C. 2d 177, 193-198 (1990), found that a series of ever-more intrusive business relationships between UP and CNW did not mean that UP had achieved control of CNW within the meaning of the same statutory provisions in the prior Act.

While these decisions seem to limit the likelihood of review by the Board of non-merger cooperative agreements, the Department of Justice ("DOJ") or the Federal Trade Commission ("FTC") might exercise jurisdiction. Dow is concerned, however that, under their existing rules and guidelines, which are not well-suited to addressing the anti-competitive effects of railroad combinations, non-merger cooperative agreements may go entirely without review.

The recently adopted Antitrust Guidelines for Collaboration Among Competitors (April 2000) indicate that most agreements among competitors will be reviewed under the so-called "Rule of Reason" to determine if the agreement "harms competition by increasing the ability or incentive profitably to raise prices above or reduce output, quality, service or innovation below what likely would prevail in the absence of the relevant agreement." Section 1.2. Unless it can be shown that the overall competitive effect of a cooperative agreement among rail carriers is anti-competitive under this stringent test, the agreement will not be subject to challenge under the antitrust laws. Thus, there may be certain situations involving non-merger cooperative agreements among rail carriers that would escape both regulatory scrutiny by the Board and review under the antitrust laws.

The absence of review does not automatically mean that there are no anti-competitive effects from cooperative agreements. In addition, such a conclusion would

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5 The Board also found that the alliance agreement would not reduce competition both because it would not facilitate improper anti-competitive collusion between KCS and CN, and because the agreement would not foreclose efforts by those carriers to compete through build-out/build-in opportunities. CN/IC at 28-31.

ignore the subtle, yet significant, anti-competitive effects that have occurred in previous mergers and been compounded by each subsequent merger. Those effects would be addressed by the enhanced competitive measures that the Board would require in the proposed merger rules. But, if the Board does not review cooperative agreements under those merger rules, the benefits of enhanced competition will never be realized.

VIII. Conclusion.

Dow appreciates the opportunity to make its views known to the Board and respectfully requests that the Board consider these comments as it develops and refines its merger rules in this proceeding.

Respectfully submitted,

Jeffrey O. Moreno
Thompson, Hine & Flory LLP
1920 N Street, N.W.
Washington, D.C. 20036
(202) 331-8800

Counsel for The Dow Chemical Company

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Certificate of Service

I certify that I have this 17th day of November 2000, served copies of the "Comments of The Dow Chemical Company" upon all parties of record in this proceeding, by First Class mail.

Jeffrey O. Moreno